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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 408

**CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE
OF A TRUST UNDER THE LAST WILL AND TESTA-
MENT OF ANGIER B. DUKE, DECEASED, FOR THE
BENEFIT OF ANTHONY NEWTON DUKE, PETITIONER**

v.

**GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE**

No. 409

**CITY BANK FARMERS TRUST COMPANY, AS TRUSTEE
OF A TRUST UNDER THE LAST WILL AND TESTA-
MENT OF ANGIER B. DUKE, DECEASED, FOR THE
BENEFIT OF ANGIER B. DUKE, JR., PETITIONER**

v.

**GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE**

**ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT**

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 31) is reported in 39 B. T. A. 29. The opinion of

the Circuit Court of Appeals (R. 176) is reported in 112 F. (2d) 457.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on June 12, 1940. (R. 181-182.) The petition for writs of certiorari was filed September 9, 1940, and granted February 10, 1941. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Commissioner of Internal Revenue conceded before the Board of Tax Appeals that the trusts involved were engaged in carrying on a trade or business, and if so, whether the Board and the court below were precluded thereby from considering the point.
2. Whether the trusts were engaged in carrying on a trade or business within the meaning of Section 23 (a) of the Revenue Act of 1928.
3. Whether certain commissions paid to the trustees were "ordinary and necessary" business expenses.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 27-30.

STATEMENT

The facts, which were in part stipulated (R. 64-71), were found by the Board of Tax Appeals as follows (R. 32-36):

The petitioner, City Bank Farmers Trust Company, is a New York corporation engaged in the business of a trust company in the State of New York. It qualified in September, 1923, as trustee under the will of Angier B. Duke, deceased, and since then has acted as such. (R. 32.)

The will of the decedent created two trusts, one for the benefit of Angier B. Duke, Jr., and the other for the benefit of Anthony Newton Duke. The petitioner received the property of the trusts in the amount of \$3,823,027.79 in each trust in February, 1926. (R. 32.)

The will provided that one-fourth of the residuary estate was to be distributed to the trustee for each of his two sons. The trustee was directed to collect and receive the income, revenues, and profits, and to apply and distribute them to the support, education, and maintenance of the son for his life, and after his death for the support, education, and maintenance of his lineal descendants, payments, applications, and distributions during minority to be under the uncontrolled discretion of the trustee (R. 34-35), with specific provision that (R. 35):

The said Trustee shall have power to hold, manage and invest, and from time to time as

need be, to reinvest the properties held in said Trust for the benefit and advantage of the beneficiaries thereof in such good and productive stocks, bonds or mortgages as will produce, if possible, a sure and regular income.

The said Trustee and its successors shall have power to retain any investments made by me in my lifetime without liability for loss or shrinkage, or to change the property received by it under this will into other property as it deems best for the respective beneficiaries, and to that end it shall have power to sell, assign, transfer, exchange, deliver and convey any property at any time, and it shall invest the proceeds of all such sales and exchanges in any property it thinks best; *but in all investments I charge it and its successors to be more careful as to the security of the funds than as to the acquisition of higher rates of interest, my desire being to have my property prudently and securely managed rather than hazarded in what may promise great gains.*

* * * * *

Said Trustee shall have power to pay all taxes, levies and assessments which may be validly imposed upon the Trust Estate, or any part thereof or in respect thereof, or which may be incurred in the exercise of any of the powers conferred by this will, as well as all costs, charges and expenses of administering this Trust, which shall include adequate insurance, necessary repairs, and com-

pensation to the Trustee for its service as such. [Italics supplied.]

The duties of the petitioner as trustee of the trusts consisted in general of causing its investment committee to review several times each year the securities comprising the corpus of the trusts; selling securities and reinvesting the proceeds in other stocks and bonds; collecting interest and dividends on securities; paying expenses of the trusts; distributing income to beneficiaries; keeping the books of account of the trusts; rendering statements to the interested parties; and preparing and filing income tax returns. The petitioner was trustee of about 300 other trusts involving similar duties. (R. 36.)

On January 2, 1931, the Surrogate's Court of New York, which had jurisdiction of the trust estates, issued a decree in a proceeding instituted by the petitioner in 1930 for settlement of an intermediate accounting for the period from February 26, 1926, to December 31, 1929, authorizing the petitioner to retain and pay to itself as trustee out of the existing corpus of the respective trust estates, as commissions to which it was entitled under the provisions of the decedent's will, the sums of \$38,641.71 and \$38,641.06. The commissions were computed pursuant to the provisions of Section 285 of the Surrogate's Court Act of New York, on the basis of principal received and paid out by the petitioner as trustee. Subsequently, during the same

months, the petitioner paid the sums authorized by the court to itself as trustee out of the principal of the respective trusts. The amounts so paid were not deducted by the petitioner in income tax returns filed for the taxable year, but petitioner asks in the petition, filed with the Board in each proceeding, for a determination of overassessment in accordance with such payments. Although deductions for other commissions with respect to the current transactions within the taxable year for receiving and paying out income are not listed in the income tax reports filed for the two trusts, and are not mentioned in the deficiency notices, the parties are in agreement that such commissions have been allowed by the Commissioner. The report made to the Surrogate by the petitioner showed commissions retained each year by the petitioner on account of income received and paid out, during the period covered by the report to the Surrogate, the amounts being \$10,663.22 as to one trust and \$10,674.60 as to the other. (R. 32-33.)

The report filed for the period from February 26, 1926, to December 31, 1929, showed an increase of corpus in one trust of \$21,635.44 and in the other of \$21,580.44, and income received of \$962,359.54 as to one of the trusts and \$963,277.83 as to the other; charged expense against principal in the one trust in the amount of \$12,806.75 and in the other of \$12,798.62; charged expense against income of \$29,608.74 as to the one trust and

\$29,815.82 as to the other, which amounts of expense in each case were entirely for payment of state and federal taxes, except \$2.50 for notary fees and \$1 for cost of federal stamps on the transfer of 250 rights in Marland Oil Company.

(R. 33.)

For 1931, the income of one estate was \$126,729.09 from interest and dividends (nothing being reported under the heading "Net profit from trade or business"), with loss on sale of securities of \$872.61, while as to the other estate the income was \$126,460.28 from interest and dividends (nothing being reported under the heading "Net profit from trade or business"), with loss on sale of securities of \$1,295.06. The loss of \$872.61 was taken upon the sale for a total price of \$86,670.38 of nine items of bonds and stocks, all acquired in 1926, except two items acquired in 1928 in the total amount of \$238.10. The loss of \$1,295.06 was taken upon the sale of 12 items of bonds and stocks in the total sum of \$90,430.42, all of the items being purchased in 1926, except one item of \$138.91 purchased in 1928. For the year 1931 the income tax report as to the one trust asks deduction of \$5.50 (in addition to taxes paid) and the other asks deduction of \$6.11 (in addition to taxes paid). The ledger of the trust for Angier B. Duke, Jr., for 1931 shows total expense items of \$13.27 charged against principal, being cost of federal stamps and cost of insurance and postage

upon bonds, and \$14.68 being cost of collection of coupons shown as expense against income; also \$30.52 costs and disbursements taxed in the Surrogate's decree of January 2, 1931. The ledger for 1931 for the trust for Anthony Newton Duke shows expense items against principal totaling \$13.03, being the cost of transfer stamps and insurance and postage on transfer bonds; and a total of \$15.71 expense against income, being cost of collection of coupons, and \$1 for transfer stamps; also \$30.53 costs and disbursements taxed in the Surrogate's decree of January 2, 1931. (R. 33-34.)

In 1931, the petitioner, as trustee of each trust, claimed deductions of about \$5,200, and distributed about \$6,300 to the beneficiary thereof out of the gross income, leaving in each case approximately \$115,000 for distribution to the beneficiary when he should become of age. For the taxable year the trustee reported a tax liability of approximately \$13,000, all of which was paid in 1932. The petitioner, as trustee of the trusts, at all times important, kept its books and rendered its income tax returns on the cash basis. (R. 34.)

The current diary of action taken by the trustee in the estate of Anthony Newton Duke shows 18 items throughout the year 1931, while the current diary in the estate of Angier B. Duke, Jr., shows 19 items. With one exception, the two diaries are duplicates. The investments referred to are all bonds and stocks. (R. 36.)

Generally trustees administering estates under the laws of New York do not make application to the court for trustee's commissions until reason exists for filing an accounting with the court. The accounting was filed in 1930 in order to obtain the court's construction of provisions of the decedent's will. (R. 36.)

Upon these findings, the Board, with five members dissenting, held that the trusts were not engaged in carrying on a trade or business, and accordingly disallowed the claimed deduction. (R. 42.) The court below affirmed. (R. 176-182.)

SUMMARY OF ARGUMENT

I

The question whether the trusts were engaged in carrying on a trade or business was open for consideration below. The question was drawn in issue by the pleadings and there was no withdrawal or concession of the point in the opening statement of counsel for the Commissioner. In any event the point may be considered to support the decision below. Since the petitioner availed itself of the opportunity of putting in evidence concerning the activities of the trusts, which showed the complete activities during the taxable year, and since it does not state what additional evidence it is able to produce which would have a material bearing upon the question under consideration, no reason appears for remanding the cases to the Board.

II

The trusts involved here were the usual type of family settlement trust. The trustee was not authorized to carry on a trade or business. The trusts were created to provide for a prudent management of the investments which the settlor had made during his lifetime, and it was contemplated that changes in the investments would be made only when required to further the best interests of the beneficiaries. A power of sale was given only to the end that these changes could be made, and was not given for the purpose of trading in the market. The evidence does not show that there has ever been any trading in the market for the purpose of making a profit from such activity. These trusts were mere investors or passive recipients of income, with incidental activities, and neither trust was engaged in a trade or business. The deduction of trustee's commissions was therefore properly disallowed on that ground.

III

The disallowance of the trustee's commissions in controversy may be supported on the further independent ground that they were not ordinary and necessary business expenses. A deduction for an ordinary and necessary business expense may be taken only if the liability was a proximate result of or was directly connected with the taxpayer's business. The right to the commissions in contro-

versy accrued under the statute by virtue of receiving the corpus, and if no business had ever been carried on by the trustee, it would nevertheless have received these amounts. The commissions were actually paid out of corpus, and are more nearly akin to capital expenditures than to current charges against the production of income.

ARGUMENT

I

THE QUESTION WHETHER THE TRUSTS HERE INVOLVED WERE ENGAGED IN CARRYING ON A TRADE OR BUSINESS WITHIN THE MEANING OF SECTION 23 (A) OF THE REVENUE ACT OF 1928 WAS IN ISSUE BEFORE THE BOARD. IN ANY EVENT, THE BOARD AND THE COURT BELOW PROPERLY CONSIDERED THE POINT

The petitioner seeks a deduction from gross income for the year 1931 of commissions allowed to the trustees based upon the receiving and paying out of principal of two trusts, on the ground that these commissions were "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" under the provisions of Section 23 (a) of the Revenue Act of 1928, c. 852, 45 Stat. 791, *infra*, p. 27. The deductions were not claimed in the returns filed by the trusts, but were sought for the first time in the trustee's petitions to the Board of Tax Appeals. The petitioner concedes (Br. 11) that the pleadings before the Board placed in issue the questions (1) whether the commissions were ordinary and necessary expenses and (2) whether they were in-

curred in carrying on a business. The petitioner contends, however (Br. 11-13), that counsel for the respondent in his opening statement before the Board conceded that the administration of the trusts constituted a business within the meaning of Section 23 (a) and that that issue was thus removed from the cases.

While counsel for the respondent did state to the Board (R. 103-104) that ordinary commissions of the trustees with respect to the current transactions within the taxable year for receiving and paying of income and all other expenses incurred in connection with the production of income in the taxable year had been allowed by the respondent as deductions as business expenses, and while the commissions on income and the other expenses were properly allowable only if the trusts were in business, there was, we submit, no express concession by counsel that the trusts were engaged in business. In the brief filed by the respondent it was urged that the trusts were not engaged in business and the Board placed its decision upon that ground. Furthermore, it seems clear from the opinion of the Board that it considered that the question whether the trusts were carrying on a business was in issue prior to the filing of the respondent's brief, for it distinguished the case of *Watson v. Commissioner*, 35 B. T. A. 706, on the ground, *inter alia*, that in that case the present question apparently arose only when the brief was filed by respondent.

(R. 37.) The petitioner filed a motion for reopening and reconsideration in the present cases, but the grounds of this motion do not appear in the record. The motion was denied by the Board (R. 44) upon the authority of *Kane v. Commissioner*, 100 F. (2d) 382 (C. C. A. 2d), which had held that commissions paid by the taxpayer in that case to a trust company for collecting her income and the sum paid to the taxpayer's brother, who took care of the taxpayer's investments, for expenses of employing a bookkeeper and of renting an office, were not expenses of carrying on a trade or business within the meaning of the revenue act.

We submit that the petitioner was informed of the issues by the pleadings in these cases and that there is no showing that it was in any respect misled by anything in the opening statement before the Board of counsel for the respondent. Neither in the court below nor in this Court does the petitioner suggest that it would have been able to produce additional evidence bearing upon the issue whether the trusts were engaged in business. On the contrary, extensive evidence was introduced by the petitioner which would have been relevant and material only if the question whether the trusts were carrying on a business was one of the issues before the Board.

Moreover, even if the question whether the trusts were carrying on a business were not one of the issues before the Board, there was no im-

propriety in the consideration of that point by the court below as a ground for supporting the Board's decision. *LeTulle v. Scofield*, 308 U. S. 415; *Helvering v. Gowran*, 302 U. S. 238. In those cases this Court held that a respondent or appellee may urge any matter appearing in the record in support of a judgment. In the *Gowran* case this Court further stated, however, that if the appellate court affirms a decision upon a new issue, it is open to the petitioner or appellant to urge that he should have the opportunity to establish before the trial body any additional facts which would affect the result. In the present cases the petitioner does not seek an opportunity for the presentation of further facts, but takes the narrow position that the point was not open for consideration by either the Board or the appellate court. We believe that this position of the petitioner is without merit. See also *Hormel v. Helvering*, No. 257, present Term, decided March 17, 1941.

II

THE TRUSTS WERE NOT ENGAGED IN CARRYING ON A TRADE OR BUSINESS

1. Section 162 of the Revenue Act of 1928, *infra*, p. 27, provides that the net income of an estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, with certain exceptions which are not pertinent here.

Section 23 (a) of the Revenue Act of 1928, *infra*, p. 27, provides that in computing net income there shall be allowed as a deduction all the "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business".

The deduction in question may be allowed only if (1) the trusts were carrying on a trade or business during the taxable year, and (2) the commissions were ordinary and necessary expenses of the trade or business. We submit that neither of these tests is met.

A majority of the Board of Tax Appeals held that the trusts did not carry on a trade or business during the taxable year and stated that it was unnecessary to pass upon the other question whether the deduction sought was an ordinary and necessary expense.¹ The court below affirmed on the ground that the trusts were not engaged in business.

On the question whether the trusts here involved were engaged in business, the cases are controlled by *Eiggins v. Helvering*, No. 253, present Term, decided February 3, 1941. That case involved an individual, while the present cases involve trusts, but we submit that this difference is not decisive. Surely, Mr. Higgins would not have been entitled

¹ Four members, who agreed with the majority that the trusts were not engaged in a trade or business, also expressed the view that the commissions in controversy were not "ordinary and necessary expenses". Five members dissented.

to the deductions which he unsuccessfully claimed merely by placing his investments in trust. The critical controversy is simply whether the activity in question constitutes the carrying on of a trade or business.

The trusts here in question were the usual type of family settlement trusts. The trustees were not authorized to continue the business, if any, which might have been carried on by the testator, nor were they authorized to engage in any new business, as the term business is generally understood. Particular property was bequeathed to the trustee to hold, manage, and invest, and from time to time as need be to reinvest the properties held in trust "in such good and productive stocks, bonds or mortgages as will produce, if possible, a sure and regular income", and to pay the income therefrom to named persons during their lives with remainders over. (R. 75-77.) The trustee was authorized to retain any investments made by the decedent in his lifetime without liability for loss or shrinkage. The trustee was further authorized to "change" the property received by it under the will as it deemed best for the respective beneficiaries, and "to that end" the trustee was given the power to sell, assign, transfer, exchange, deliver, and convey any property at any time, and to invest the proceeds of all sales and exchanges in any property it thinks best, and it was charged by the decedent in all investments "to be more careful

as to the security of the funds than as to the acquisition of higher rates of interest, my desire being to have my property prudently and securely managed rather than hazarded in what may promise great gains." (R. 78.) The decedent further expressed the wish that the trustee should advise and consult with his executors and his uncle upon and with reference to the sale or exchange of any property received by it under the will or with reference to any investment or reinvestment of funds or money coming into its hands before making the same, to aid but not to control the trustee's discretion. (R. 79.)

Insofar as the actual handling of the trusts is concerned, it does not appear from the present record that at any time during the existence of the trusts has there been any trading in stocks, bonds, or other property with the purpose of making a profit from such trading. The officer of the petitioner in charge of these trusts testified (R. 113):

At the time the corpus was received the principal consisted of bonds and stocks; there were holdings of the Duke Power Company in each trust; they were the chief holdings, and they were still held up until 1931, without material change, unless they were added to. The trustee may have bought more Duke Power Company stocks or bonds during that time, but as far as I know they still have what they started out with. Money was paid out to the benefici-

aries from time to time, and the remaining amount of income was invested.

Such sales as have occurred of trust assets have been few in number and have been for purposes other than realizing a profit. In the Anthony Newton Duke trust, there were sales in January, 1931, of four blocks of bonds for an aggregate sale price of \$60,646.28. These sales were for the purpose of paying the trustee its commission of \$38,641.71, allowed by the order of the Surrogate Court, and to make up a deficit in cash account of the principal of the trust. (R. 125, 157.) In July, 1931, \$18,000 of bonds of the State of Montana and the County of Duval of Florida were redeemed, and the proceeds were reinvested in tax-free municipal bonds. (R. 126, 158-159.) In December, 1931, the offer of the American Tobacco Company to purchase 100 shares of American Cigar Company stock for \$7,996 was accepted, and the proceeds were reinvested in January, 1932, in non-taxable municipal bonds. (R. 126, 161.) The only other transactions in the corpus of this trust during 1931 were the sales in June and September of certain warrants on Aluminum, Ltd., stock for a total of \$238.10. (R. 126.) The following diary entry on this latter transaction clearly reflects the nature of the present trust as one for the conservation of property (R. 160):

Under date of September 3rd, Mr. W. R. Perkins has answered our inquiry of Sep-

tember 2nd, in reference to the sale of the warrants expiring Oct. 1 on the Aluminum, Ltd. stock. He says: "Replying to yours of the 2nd, do you consider yourselves authorized by the terms of the Trust to exercise these warrants and make that kind of an investment? While we think well of the future of the company and realize what we hope is the abnormal lowness of all things now, it is not an investment for trust funds." We are accordingly proceeding to sell the warrants.

During the entire year 1932, the only sale recorded in the capital account of this trust was one on July 21 to reverse as of July 6 a purchase made on that date (perhaps because the entry should have been in the income account). (R. 126.)

Other than the activities incident to the collection and distribution of income, the only further transactions by the trustee in 1931 were in connection with the investment of the undistributed income, all of which was used to buy tax-free municipal bonds. (R. 157-162.)

The Angier B. Duke, Jr., trust was handled in substantially the same manner as the trust for his brother. (R. 114, 141-142, 163-168.)

It is apparent, we submit, that the trustee of these trusts was neither authorized to trade or speculate in securities nor has it ever undertaken so to do. Indeed, in view of the terms of the will which created these trusts, the trustee was for-

bidden by state law from trading or speculating or engaging in business. *Warren v. Union Bank of Rochester*, 157 N. Y. 259; *In re Kinreich's Estate*, 244 N. Y. Supp. 357; 2 Scott on Trusts, Sections 227.6, 230.4. Such buying and selling as did occur were merely isolated transactions incidental to the proper conservation of the trust property. The activities of the trustee were limited to those traditionally carried on by a strict trust. The activities of the trustee were not different in either kind or degree from the activities of the individual taxpayer in the *Higgins* case, and there is, we submit, no justification for the contention that the activities constitute a business merely because they are engaged in by a trust. No case cited by the petitioner and none that we have found holds that activities which would not be a business when engaged in by an individual become a business when engaged in by a trust. To sustain the contention of the petitioner in these cases would be tantamount to holding that *all* trusts carry on a business within the meaning of the revenue act. Both reason and authority are opposed to that view. See *White Trust v. Commissioner* (C. C. A. 3d), decided October 9, 1940, not yet officially reported but found in 1940 C. C. H., Vol. 4, par. 9712, now pending on petition for rehearing; *George Vanderbilt Trust v. Commissioner*, 36 B. T. A. 967; *Estate of Mary R. Donald v. Commissioner*, 43 B. T. A. —, decided March 25, 1941. Cf. *Morrissey v. Commissioner*, 296 U. S. 344, 356-

357.² Yet, it is implicit in petitioner's brief, if not explicit in the *amicus curiae* brief submitted on behalf of the Committee of Banking Institutions on Taxation, that what is sought here is a declaration that *all* trustees' commissions are deductible. But since the statute allows the deduction only in connection with the carrying on of a trade or business, it is obvious that such position can not be supported.

The cases cited by the petitioner (Br. 20-21), which held that the trusts there under consideration were taxable as corporations, involved trusts which were actively conducting an investment business or were buying and selling securities for the benefit of the investors. The activities of the trusts in those cases, however, were different in kind and degree from the activities of the trusts in the present case. Those cases recognize a distinction between a strict trust and a business trust. There can be no doubt, we submit, that the trusts here involved were strict trusts, and accordingly it should be held that they were not carrying on a trade or business within the meaning of Section 23 (a).

² Indeed, there are numerous cases holding that even corporations which are in the position of passive recipients of income do not carry on a business. *McCoach v. Minehill Railway Co.*, 228 U. S. 295; *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503; *United States v. Emery*, 237 U. S. 28; *Zonne v. Minneapolis Syndicate*, 220 U. S. 187.

2. The petitioner urges (Br. 13-17) that under settled administrative practice trustees' commissions have uniformly been allowed as business expenses and that this practice has been approved by Congress through repeated reenactment of the statute. A similar contention was made in the *Higgins* case, and petitioner's position here rests upon no firmer ground.

Concededly, there are no treasury regulations in point. Five informal rulings are relied upon by the petitioner. The first of these, S. O. 88, 4 Cum. Bull. 119, 120, promulgated in 1921, was based upon the proposition that "It is settled that where substantially the entire income of a taxpayer is received from investments and dealings in securities, such investments and dealings in securities constitute the carrying on of a trade or business". The ruling further stated (pp. 120-121): "In this case the executors are engaged in trade or business only to the extent that they continue the business of the decedent, and only such expenses as are incurred in continuing the business of the decedent are allowable deductions in computing net income".

The next ruling relied upon by the petitioner, I. T. 1393, I-2 Cum. Bull. 83, promulgated in 1922, merely stated that under a liberal interpretation of the law, trustees' commissions are deductible from the gross income of the trust estate. S. M. 2463, III-2 Cum. Bull. 91, promulgated in 1924,

quotes from and follows S. O. 88, and the remaining two rulings in turn follow S. M. 2463.

The trusts which are involved here were created in September, 1923, by a will executed in December, 1922. At the time of the execution of the will less than two years had elapsed since the promulgation of the first ruling relied upon by the petitioner, and of course no argument can be made that the decedent acted upon a long and consistent administrative practice.

All of the rulings proceed upon the theory that where substantially the entire income of an individual is received from investments and dealings in securities, such investments and dealings in securities constitute the carrying on of a trade or business,¹ and consequently that when an estate or trust continues these activities it also is engaged in a business. The decision of this Court in *Higgins v. Helvering*, *supra*, demonstrates that the rulings were based upon a false premise. Since the premise falls with the *Higgins* case, the rulings based upon that premise should no longer be accepted. Cf. *Estate of Sanford v. Commissioner*,

¹ See O. D. 877, 4 Cum. Bull. 123 (1921), issued contemporaneously with S. O. 88. On February 24, 1941, O. D. 877 was revoked as being inconsistent with this Court's decision in the *Higgins* case. See I. T. 3452, 1941-8 Int. Rev. Bull. 4. In the issuance of this latter ruling, the Treasury refrained from revoking S. O. 88, S. M. 2463, and other rulings of similar import because of the pendency in this Court of the present case and *United States v. Pyne*, No. 683, present Term.

308 U. S. 39, 53-54; *Burnet v. Chicago Portrait Co.*, 285 U. S. 1, 16; *Morrissey v. Commissioner*, 296 U. S. 344, 354.

Furthermore, the rulings relied upon were not promulgated by the Secretary of the Treasury and therefore are of little aid in interpreting the statute. *Helvering v. N. Y. Trust Co.*, 292 U. S. 455, 467-468; *Biddle v. Commissioner*, 302 U. S. 573, 582. In addition, the practice in respect of estates and trusts has not been consistent. See *Watson v. Commissioner*, 35 B. T. A. 706; *George Vanderbilt Trust v. Commissioner*, 36 B. T. A. 967; *Reising v. Commissioner*, 17 B. T. A. 327, affirmed, 47 F. (2d) 859 (C. C. A. 8th); *Ames v. Commissioner*, 49 F. (2d) 853 (C. C. A. 8th). In short, the administrative practice in respect of estates and trusts is not materially different from the administrative practice which this Court held not controlling in *Van Wart v. Commissioner*, 295 U. S. 112, and *Higgins v. Helvering*, *supra*, and, we submit, it should not be accepted as controlling here.

III

THE TRUSTEE'S COMMISSIONS WERE NOT AN ORDINARY AND NECESSARY BUSINESS EXPENSE

Four members of the Board, although agreeing with the majority that the trusts were not engaged in a trade or business, were also of the opinion that the commissions in controversy could not be said to be "ordinary and necessary expenses", even if

the trusts were engaged in a trade or business.
(R. 42-43.)

The commissions in the case of the Anthony Newton Duke trust were allowed for receiving the sum of \$3,844,663.23 of principal and for paying out the sum of \$12,806.75 of principal, and in the case of the Angier B. Duke, Jr., trust for receiving \$3,844,608.23 of principal and for paying out \$12,798.62 of principal. (R. 87-88.) The trustee was directed by the Surrogate Court to pay these commissions out of principal. (R. 87-88.)

It is settled that a deduction for an ordinary and necessary business expense may be taken only if the liability was a proximate result of or was directly connected with the taxpayer's business. *Kornhauser v. United States*, 276 U. S. 145, 153. It would seem that the expenditures in question are more nearly akin to capital expenditures than to the ordinary and necessary expenses of operating a business. Cf. *Welch v. Helvering*, 290 U. S. 111. The right to the commissions, constituting one-half of the statutory allowance, accrued under the statute by virtue of receiving the corpus. See *Matter of Schinasi*, 277 N. Y. 252, 264. If no business had ever been carried on by the trustee, it would nevertheless have received these amounts. *In re Allen*, 96 N. Y. 327. The fact that they were paid out of corpus, if not conclusive, is at least persuasive evidence that the expenditures were not made to "carry on" the busi-

ness, if any was engaged in. Cf. *Vernor v. United States*, 23 F. Supp. 532 (C. Cls.); *Bing v. Helvering*, 76 F. (2d) 941, 942 (C. C. A. 2d); *Mahler v. Commissioner*, 32 B T. A. 644.

We further submit, therefore, that the payments here sought to be deducted did not proximately result from and were not directly connected with any business carried on by the trusts and accordingly were not ordinary and necessary business expenses. The decision below may accordingly be supported on this additional, independent ground.

CONCLUSION

The judgments of the Circuit Court of Appeals are correct and should be affirmed.

Respectfully submitted.

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MARCH, 1941.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an addi-

tional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 121. *Business expenses.* — Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141-271. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items

not deductible, see section 24 and articles 281-281.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See article 67.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Act, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expendi-

tures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

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